DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92038

36 Letters per Year – $125 Annually

Registered with the Securities Exchange Commission

September 15, 1976 Letter 675

Sept. 3, DJIA 989.11; PTI 695; A-D Ratio -22.46
Sept. 10, DJIA 988.36; PTI 703; A-D Ratio -22.25

CRY GENIUS! If you are in the investment advisory business, then you know that 1976 is the year that knocked most of the services silly. Almost everyone's been wrong in some major area whether its stocks, bonds, gold, silver, or money rates. I can thank my indulgent subscribers for keeping the subscription list here at an all-time high, but I'm not at all sure I deserve it. I have, however, learned one thing after 18 years in this business, and that is that at times we have to refrain from the temptation to "play genius."

Every investment advisor loves to bring out that special letter headlined "Buy 'em" or "Sell 'em." But 1976 was not the year for that kind of dramatic effort. I had felt all along that '76 was going to be a drawn out, tedious affair. I felt that we should be enthusiastic about bonds (I did say "buy 'em") but somewhat cautious regarding stocks. We've been sweating out this bull market all during 1976, and it's been a market which teetered between "nervous and messy" and "dull and boring!" Nevertheless, as long as the June lows hold for the D-J Averages, optimists are within their rights. And that means that we continue to sit with our current cautiously scaled-down stock positions and our aggressively large bond positions (I hope all subscribers, by this time, have positioned themselves in bonds).

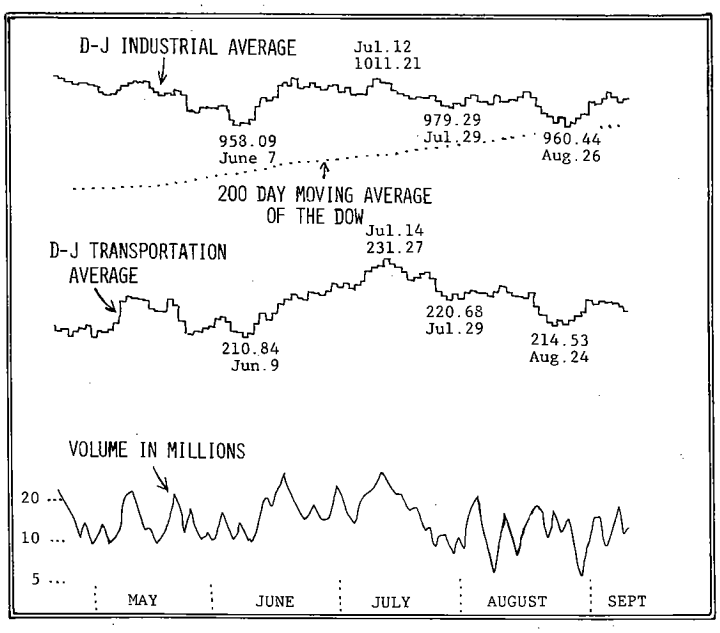
THE PICTURE: Sometimes we can clarify a confusing picture by analyzing what has happened in the market and what has not happened. Let's start with what has happened.

(1) Last week the D-J 20-Bond Average hit a high for the year (it is still just a fraction below its 1973 high of 88.91.
(2) The D-J Utility Average recorded a new bull market high.
(3) The Primary Trend Index or PTI (see page 2 chart) struck a new bull market high.
(4) The cumulative most-active stock index (CMAS) touched a new bull market high.

Now let's list a few items that did not occur.

(1) The major Composite Averages have now all broken their major rising trendlines, yet none of them have violated their June lows (see chart).
(2) The D-J Industrial and Transport Averages, although they did not move to new bull market highs, have held stubbornly above their June lows.
(3) The D-J Industrials came down and touched the 200-day moving average, but it did not break below it (the 200 day MA now stands at about 964).
(4) The A-D ratio, having rallied to within a fraction of its February 24, 1976 bull market high, failed to better that level.

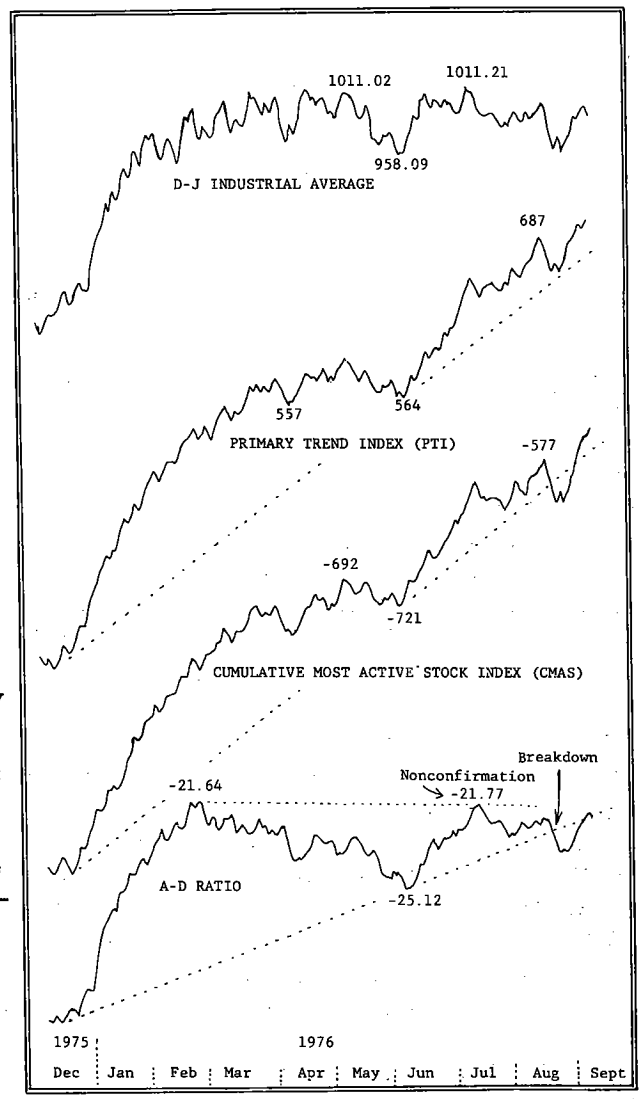
What do I conclude from all these happenings and non-happenings? My own feeling is that this market is being held up (and at times being pushed up) by powerful forces in the money market. I have written many times that bullish trends in the D-J Bond and Utility Averages constitute a positive background for stocks. We have certainly had a remarkably strong Bond and Utility market. In fact, I would say that the rising trends in those two sectors have been the most persistent forces on Wall Street since mid-1976.



The composite indicator chart on page 2 gives us a fair indication of where the market is at this time. Note the strength in the PTI. Two of the eight components in the PTI are money oriented (Bonds and Utilities), and without these the PTI would not be at a new high. But the fact is that the PTI did record a high last week, and as long as this is the case, the market will continue to hold. This is another way of saying that no market ever fell apart while the PTI was hitting new highs.

The cumulative most-active stock index is simply an advance-decline line of the daily most active issues. The CMAS shows us where the concentration of high-volume activity is— on the buy side or the sell side. Last week this index recorded new highs. Thus, the PTI and CMAS clearly deserve bullish labels. So far so good.

The problem side of this market has to do with the action of the D-J Averages and the Advance-Decline ratio. While these three could all turn bullish in a matter of a week or so, we have not had that happy resolution so far— and the weeks continue to drift by. The high for the D-J Industrial Average was recorded on July 12 at 1011.21, while the Transport high was struck on July 14 at 231.27. The A-D recorded its bull market high on February 24, 1976. And although the A-D is very close to the February high now, the ratio (as of this writing) has still not climbed over the earlier peak.



Question: What would you say about this market from a Dow Theory standpoint?

Answer: From a strict Dow Theory standpoint, I would say that we should continue to give the benefit of the doubt to our old friend, the bull. We have important lows recorded on June 9; 958.09 for Industrials and 210.84 for Transports (see page 1 chart). As long as one or both Averages hold above those levels, it would be well to remain bullish on the secondary trend (as well as the primary trend, of course). In late August the Averages recorded lows of 960.44 and 214.53. If those lows are jointly broken, we have the June lows directly below. If the June lows are jointly broken, my guess would be that the second phase is over and that the market would be ready to move significantly lower by election time.

Question: The A-D ratio is now quite near its February 24 bull market high. Suppose the A-D did rally to a new high but the Dow refused to confirm?

Answer: First, let's review a little history. Following the February 24 A-D peak, the Dow advanced and recorded two unconfirmed highs (unconfirmed by the A-D ratio). The first high was recorded on April 21, 1976 at 1011.02, and the second was hit on July 12 at 1011.21. At the time of the July high on the Dow, I expressed concern. My concern was based on the fact that a peak on the A-D ratio followed many months later by new (unconfirmed) highs on the Dow has all too often been the forerunner of trouble.

Seven months have now passed since the peak on the A-D ratio. And although we have not had real trouble, we have not had a particularly inspiring market either. If the market now pulls a switch on us and gives us a new high on the A-D ratio unconfirmed by a new high on the Dow, I will be just as concerned as I was when the situation was reversed. History records a number of instances in which important new highs in the A-D ratio, unconfirmed by a new high in the Dow, set off reactions. Perhaps the most outstanding instance occurred in April, 1934. At that time the A-D ratio pushed above its January peak, but the Dow failed to better its own January peak. The market then went into a severe reaction which lasted into September.

Question: I've noticed that all during the period of February, 1976 to the present, we have had a series of non-confirmations in the various indicators and averages. What does that mean?

Answer: This kind of action, I'll admit, always bothers me. But I don't want to be a perfectionist. Wall Street always gives you something to worry about, even during the most profitable bull movements. I've been talking about the A-D non-confirmation ever since April. Last week the A-D put on a fair show, but it was the Dow itself that looked weak. At the same time, the Dow Transports have turned quite sluggish, and they're still 10 points under their August peak.

I have never liked markets that get "out-of-gear" for long periods of time as this one has done. My head says, "Give it time, let it tell its story," and my emotions say, "I don't like it, there's a wrench caught in the cogs somewhere, and if it picks up speed it's going to kick itself apart." In such cases, I generally let my head rule. I'm doing that now.

General Conclusion: The monetary and interest-oriented segments of the market have been strongly bullish since May, 1976. But the action of the Averages and the A-D ratio has been hesitant and sporadic. While the monetary factors have indicated that liquidity is building up (and of course this is basically bullish), something else seems to be bothering Wall Street. That "something else" is reflected in the hesitant action of the Industrials, Transports and A-D ratio. As long as those three hold below their 1976 peaks, we are entitled to remain rather cautious. But as long as the June lows hold on the Averages, we can refrain from converting our caution into outright bearishness.

In these Letters, I have always stressed the how of the market, rather than the why. Everything I have written so far in this report deals with how (or basically what the various averages and indicators are doing). Why they are acting this way is a question which one can discuss at dinner, at the club or at the tennis courts. The why of the market is always fuzzy and always interesting. The

how of the market is critical for investing, and it is here that our bank accounts will either be fattened or decimated.

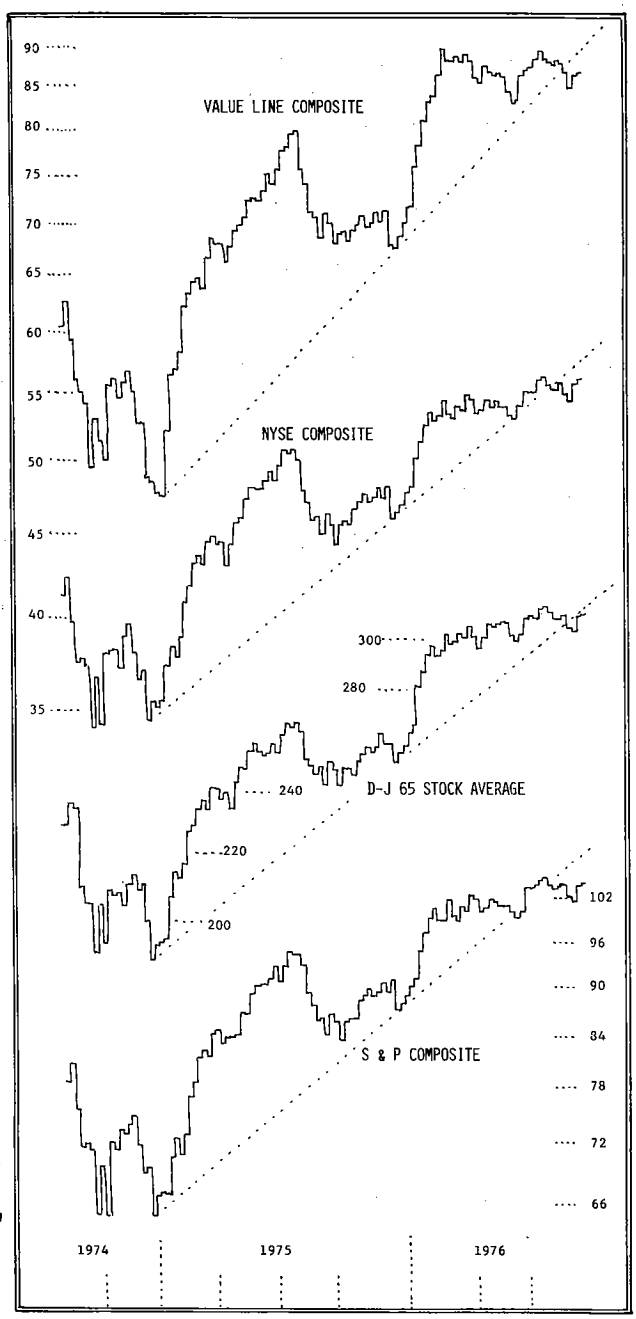
CHART STORY: I've often thought that it would be interesting to put out an issue of Dow Theory Letters which might resemble a "chart comic strip." Each chart would be part of the current market story. Thus, a minimum of talk, analysis and explanation would be necessary. The whole story would simply be there on the chart series.

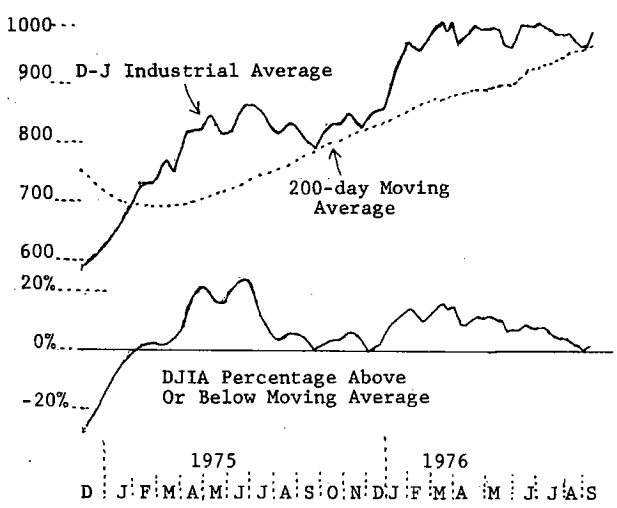
At any rate, I am going to try to do something like that with a few charts now. The first chart shows the four major Composite Averages. In Letter 672 I noted that two of the Composites had ruptured their "upward growth rate" by breaking their rising trendline, trendlines that began at the 1974 lows. Those two Averages were the NYSE Composite and the S&P 500 Composite.

On the week ending August 13 the D-J 65 Stock Average joined the other two by breaking its rising trendline, and two weeks ago the Value Line Composite completed the story by sinking below its own rising trendline. So the question is, "With all four major Composites now fluctuating below their major rising trendlines, what is the market telling us?" And my answer is that the great upward rate of ascent which held in effect from December 1974 to July 1976 has now "simmered down," or to be blunt about it, the rate has changed.

"So the ascent rate has changed," you snap, "and what does that really mean?" It means that the action from here is going to be at a slower pace. And it could even mean (although this is not certain) that the market is in the process of building a top, preparatory to the breakup of the second phase of the bull. As far as the slower pace is concerned, there is nothing unexpected about this phenomenon. As far back as May 19, 1976 (Letter 664)I wrote that "the 1974-76 rate of ascent cannot be sustained, it is simply too steep." That warning came to pass, in the form of a long tedious "line" in the Averages (as I suggested it might).

But what about a correction? Could the break in the four Composite Averages' trendlines be the prelude to a further important downside movement? And here the answer is yes, we could have a correction, but since we are now in a somewhat cautious position, I do not see the sense in wringing our hands over that possibility. If it comes, well, let it. We'll have time to act. We have the June lows on the D-J Averages to watch, and we have many other indicators to monitor. So that's the message being provided by the Composite Averages, "high clouds instead of a perfectly clear sky, but no storm clouds yet."



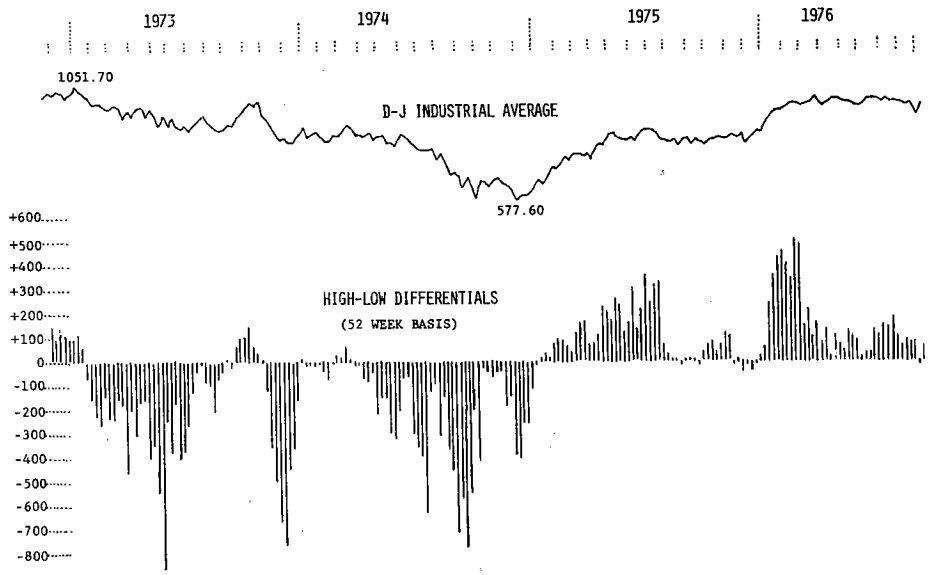


Next chart, the Dow and its 200-day Moving Average. For the third time since this bull market began (in December, 1974), the Dow has come down and touched its 200-day MA. My guess is that the Dow will tend to hold at or above the 200-day MA until the second phase of the bull market has ended. When that happens, we should get a correction which will take the Dow well below the 200-day MA.

Finally, I am updating a chart (page 4) which I included in Letter 670. It shows the net differential of weekly new highs and new lows. But these are based on M/G Financial's running 52-week tabulations, not on the D-J tabulations which run to March of each year, then revert back to January. The M/G system is far superior and no "adjustment" is ever necessary.

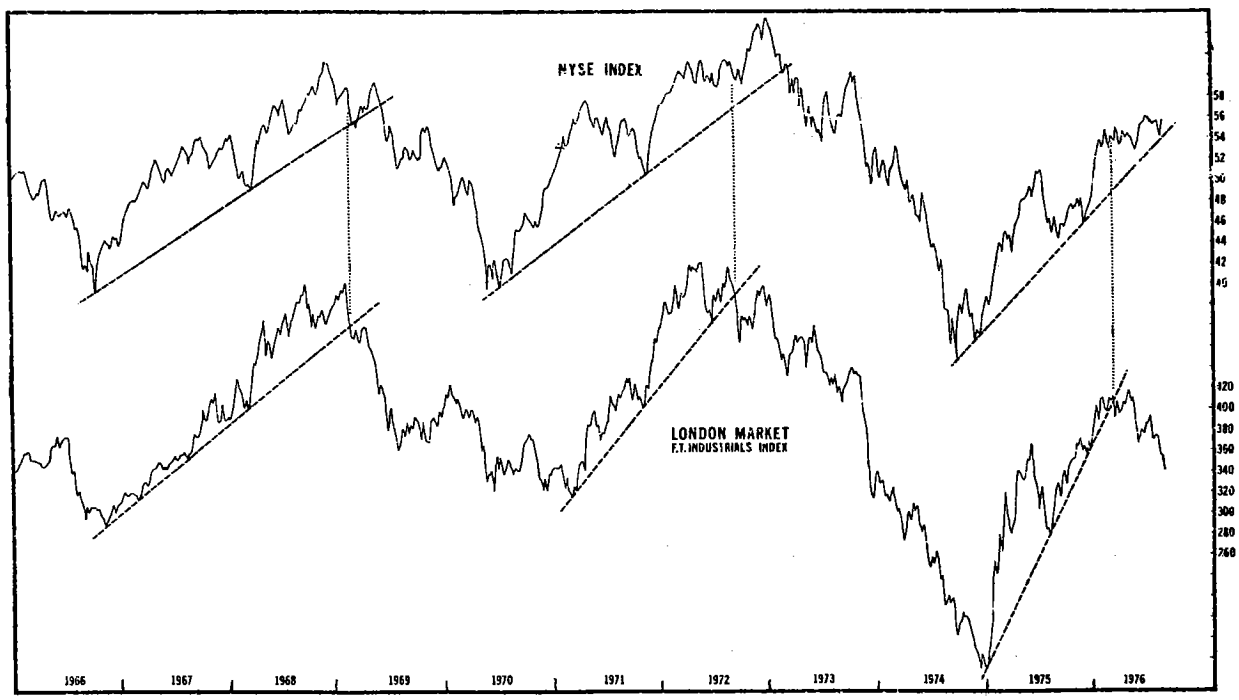
Two factors are worth commenting upon as we study the chart. The first is that the high-low differential fell off drastically during the second part of 1976, even though the Dow (in mid-July) recorded a new bull

market high. The second factor is that on the week ending August 30, the high-low differential dipped into the minus column (even though it was only minus 6) for the first time since November, 1975. Thus, the high-low figures at this juncture are less-than-encouraging but not yet bearish.

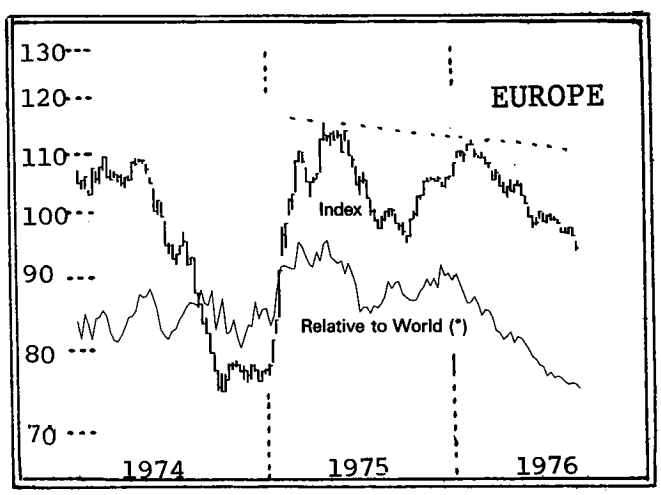


OVERSEAS VIBRATIONS: An awful lot of data pours into this office each week, and often it is information that other people just don't see. I study it, I try to put it together, I try to construct some kind of an overall story out of it. Once in a while, I see a chart or a situation that makes me do a "double-take." The overseas stock markets are worth a very careful second look right now.

In the last Letter I included a chart of the British market, and it's not a particularly happy picture. The fact is that the London Bridge has been falling down. I discussed in the last report how London often forms tops prior to U S tops, and this week I noticed an excellent chart in the CMI Service (1133 N. North Camano Dr., Camano Island, WA 98292) dealing with the London-NYSE relationship.



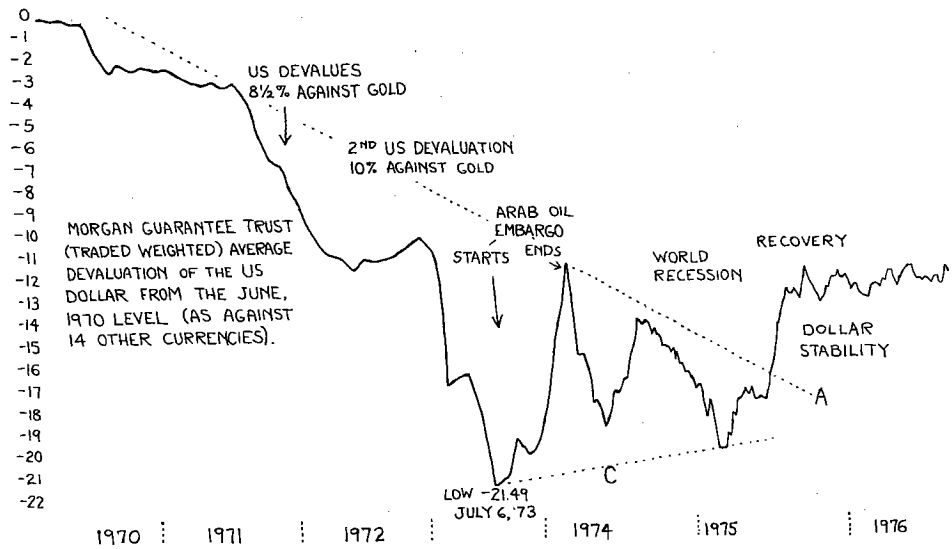
The chart is self-explanatory. In the period going back to 1966, each time London has broken its major rising trendline, Wall Street has managed a final spurt and then joined London on the downside. As seen on the chart, London ruptured its main trendline about March of this year. Wall Street has continued its rally. Last week London hit a new 1976 low of 338. Thus, the London-NYSE relationship does not bode well for Wall Street at this time.



But what bothers me even more is this chart which is a composite of ten leading European stock averages (courtesy of Capital Int. Perspectives, 15, rue du Cendrier, 1201 Geneva, Switz.). The composite is now quite bearish. We see a 1975 high, a major secondary low in late '75, a 1976 peak below the '75 high, and then (last month) a breaking of the '75 low. The chart is indicating that the whole Free World is experiencing a stock slump and perhaps the beginning of an economic recession. The composite merely reflects the individual situations. For instance, Germany is sliding, France is slumping badly, Switzerland is coming down, the

Netherlands has just caved in, Italy has been sliding for three years, Belgium is halfway back to its '74 low, Sweden is falling apart. All of which could easily fit in with my thesis of the "ending of the second phase of the bull market" (as explained in the last Letter). It also fits in with my concept of declining inflation— and maybe a bit of net deflation.

GOLD: Many if not most of the "gold experts" have been beaten into the ground. Gold-oriented services have folded, advisors have slunk away, others are insisting that "Gold is on its way back," and still others wish they had never heard of gold. Charles Stahl (who is no gold bug) of Green's Commodity Market Comments thinks gold is bottoming out now amid a pool of pessimism, Harry Schultz thinks 90 would be about the low. Others are waiting to see whether gold breaks 100. Almost everyone from Russia to Italy to S.Africa "wants" gold to go up. Except the US. The US doesn't give a damn, and it would much rather the world accepted the dollar forever while putting all the gold in existence back in the ground.



"How are 'they' going to get gold up again?" the goldphile asks. And my answer is that gold won't go up five cents because some group or individual or nation wants it to go up. Gold will go up when the sellers are exhausted and when the buyers know the sellers "have had it." There's simply no way of accounting for that magic bottom day in a bear market, that day when the price movement runs out of downside steam, as the Dow did for instance, on July 8, 1932 or December 6, 1974. From experience, we do know that the bottom day usually passes before anyone even knows it has come and gone.

One of the points I watch in a bear market is the halfway level between the low of the preceding bull market and the high. The halfway level for the $35 to $200 rise for gold is 117. When gold broke 117 on the way down, I felt that an important technical prop had given way. That 117 level should now be a point of technical resistance on any rally, and it will be worth watching to see what happens if and when gold rallies to the 117 level.

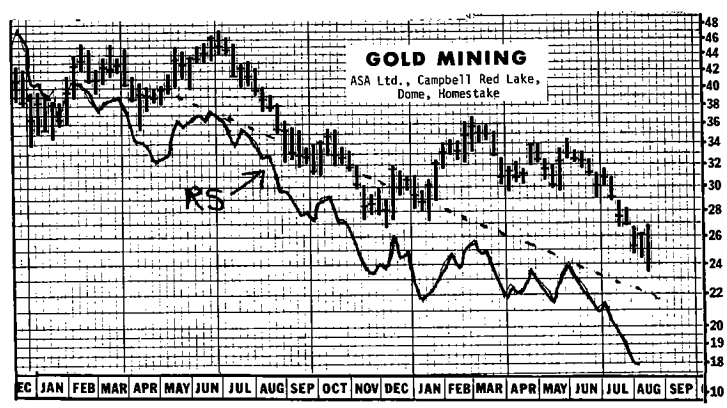
Personally, I have no idea whether the 103.50 low of August 25 was THE LOW for gold or not. I would guess, since many experts are now freely predicting a drop below 100, that the 103 level did represent the bottom.

But what bothers me about buying gold here is that I suspect that we could be going into a gold market which will shape up something like the 1976 stock market. With a decline in the national inflation rate, I wonder whether gold owners (and I own some) will not be sitting with a "do nothing" item for many, many months or even for a few years.

Gold is a play against the dollar. But right now, the dollar is strong, and in fact my trade-weighted dollar chart shows that the dollar has been strong since mid-1975 (having broken up through a five-year declining trendline). As I see it, the US has a relatively stronger economy at this time than any other in the world, and this means a strong dollar. A strong dollar means a strong US bond market, and at this time the D-J 20 Bonds is just a fraction under its 1973 high! Remember, I have been saying that we are on the edge of a bull signal in bonds, a signal which would be set off if the D-J 20 Bond Average moves above its 1973 high of 88.91. If that happens, I would say that we would be seeing the first primary bull market in bonds since 1946. And that, readers, is (1) not inflationary, and (2) not bullish for gold.

Maybe we should turn all the above into a simple axiom. The axiom would run, "A strong bond market and a strong dollar is bearish for gold. Conversely, a strong gold market is a play against the dollar and therefore against dollar instruments, particularly fixed dollar instruments such as bonds."

What of the gold shares, you ask? Here we have but to study Gold Mining Averages (courtesy of Security Research, 208 Newbury St., Boston, Mass 02116). The continuous line portrays relative strength (RS), and as you can see, the RS line is still well below its declining trendline. Regardless of nearby pops, sags and fluctuations, I would not move into the gold shares in any significant way unless or until RS in the Gold Group reverses



to the upside. This has not happened so far. I want to remind readers that many of the gold shares have panicked down, to August lows, and the surest thing in the market is the automatic recovery following a panic. The recovery may recoup as much as half of the panic losses, following which the price movement usually comes down again to test the panic lows. We could well be in the automatic recovery period now, and if so there will be a test of the lows.

NEW ORLEANS: I'm off to New Orleans to the big Conference sponsored by the National Committee for Monetary Reform. From what Chairman Jim Blanchard tells me, the crowd should be so big that New Orleans may run out of chicken gumbo. I will be seeing a great many old friends, and it should be very interesting. I don't know if there is still room, but if you are so inclined, call (504) 865-9919 and they'll give you late info.

THOUGHTS: Jimmy Carter may be his own worst enemy. The fact is that he knows very little about economics, and he is now sliding off his "far-left" seat and moving towards the center. If he senses that the certer position won't "work," he'll probably turn into a conservative. Carter really has no economic philosophy of his own, and the nation is beginning to realize that. Of course, no philosophy is better than one that isn't workable, and as usual Carter is leaving all the options open. I feel that his debates with Ford could be the key to the election.

* * *

The deferred income savings plan and the deferred annuities have been receiving a lot of publicity. The question I ask myself is why are these any better than just buying a Municipal bond fund that is tax free (at least free from Federal taxes)? For one thing, deferred annuities can be placed outside one's estate. A second possible plus is that the deferred plans usually guarantee your principal whereas bond funds can go down in market value. However, on the deferred plans you eventually have to pay the taxes (unless you die) whereas on the Muni's they are totally tax free. Best course of action: purchase part Muni funds, part deferred annuities, diversify.

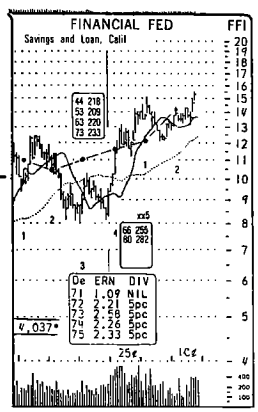
* * *

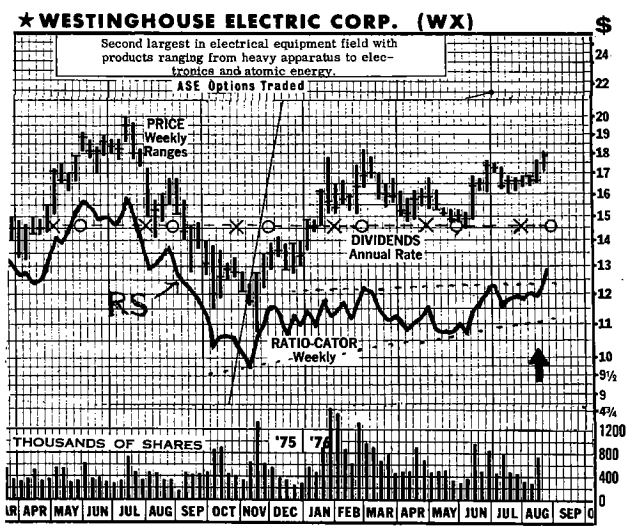
Everyone is always writing about business success, which is great. Personally, I learn just as much from failure. For instance, do you know what the four greatest losses in corporate history were? Here they are. The Penn-Central's $1.1 billion loss between 1970-72. The recent RCA $490 million write-off of its computer business. The General Dynamics 1960-62 $425 million loss on Convair. And the Ford $350 million write-off of the Edsel, which was the greatest loss on a single product in corporate history.

* * *

Speaking of losses, the peso is now floating and it has dropped better than 40% against the dollar. I have been getting letters for the past two years asking about investments in Mexico, and my answer has been that Mexico has a history of confiscation, so "don't do it." Now Americans with peso holdings have seen their "investments" drop 40% overnight.

Being 20 miles north of the Mexican border, I am in a position to see what happens after a whopping currency collapse. For one thing, stores on this side of the border have seen their business cave in (because Mexican goods are now so cheap in terms of dollars). Second, the Mexican government has now frozen prices, meaning that they want those dollars flowing in to buy currently "cheap" Mexican goods. I used to go down to Tijuana or Tecate every week or so, but over the past three years I have stayed away. I felt that the place not only wasn't a bargain, it was a rip-off. Ultimately, prices and currency seek their real value. In my opinion, the dollar buys a lot of value here in the States. It's one of the world's best currencies in terms of what it buys today (in case you're interested, prices in much of Europe are ridiculous and people I meet who have returned from Europe are literally furious).





STOCKS: Two stocks previously recommended strike me as acting outstanding. Westinghouse has broken upside in relative strength and is an interesting situation with steadily improving earnings. Now selling at 8 times earnings, with the minus being the WX mess in selling forward uranium contracts too cheaply. If that's straightened out, then WX looks like a bargain at these prices. Another stock which looks good is well-managed Financial Federation, a West Coast Saving & Loan company with steadily improving earnings. FFI, despite earlier appreciation, sells at about 5 times earnings, and is now paying cash dividends. These two stocks are well worth holding. (WX chart courtesy of Securities Research, FFI chart courtesy of Quote, PO Box 213, Wichita, KS 67201. These are both excellent chart services with carloads of data besides charts).

LATE MARKET NOTES: The market is very overbought here, and it became overbought without making too much upside progress. The Transports (see page 1 chart) are developing a disturbing downside divergence. But let's continue to keep our cool. A bull market can take an awful lot of mangling and pushing around and still "pull itself together."

....I'm watching the English and European markets (they're acting terribly), I'm watching the 89 level on the D-J 20 Bonds (I hope it's bettered), and I'm watching the D-J Transports— they don't want to go up. Other than that, I'm hoping it isn't too hot in New Orleans, and I'm going to try to get the next Letter in the mail on Sept. 24 (that Letter may be abbreviated because of the New Orleans trip).